

Retail World: for Aug 4 Issue

New carbon economy: what it means for FMCG

Major retailers seeking to reduce their carbon emissions will be looking at their supply chain, in the wake of the new Australian carbon pollution reduction scheme. Shoppers will increasingly look to the carbon footprint of the products they buy.

- *by the FMCG Sustainability Institute, a joint initiative of Shoppportunity and EcoSTEPS to provide Sustainability thought leadership, research, education and advice to the FMCG industry. For more information visit www.fmcg-sustain.com.au*

Whether you are a climate change believer or skeptic, one thing is for sure: the carbon issue is escalating and will have a major impact on the economy more broadly, and FMCG specifically, over the next few years.

The recent release of Garnaut Report, calling for strong action to mitigate major environmental and economic threats, has been followed by a further green paper detailing the design of the Federal Government's proposed carbon pollution reduction scheme. The Government has stated its intention to activate the program in 2010.

According to the green paper, around 1,000 businesses that emit more than 25 000 tonnes of carbon a year will need to buy 'pollution permits' and account for their emissions.

What will carbon trading mean for the FMCG and Retail industry?

In the short term, some of the major retailers and the very largest emitters on the manufacturing side will be required to report their carbon emissions over the next two years and a cap will be set per company that cannot be exceeded after 2010. Some of the larger companies are already reporting on a voluntary basis. As of 2010, companies that do not use their entire allocation will be able to on sell their carbon credits to companies that are exceeding their cap: a strong economic incentive (both carrots and sticks) for reducing footprint.

Companies that are not so large may still enter the scheme by reporting energy and emissions now on a voluntary basis, in order to provide accurate data for the longer-term setting of their own cap (rather than having the cap set *for* them later without accurate data).

Eventually, it is widely recognized that *all* companies will be required to report. This presents a two-edged sword to our industry, both opportunity and risk:

- opportunity to leverage Sustainability as competitive and commercial advantage now, and;
- risk of penalties and increasing costs if carbon emissions are not reduced.

Companies such as David Jones and Coca Cola are leading the charge in terms of overall sustainability score, and Woolworths is already ahead of the game on the carbon issue. The company has been reporting their energy and emissions data to the Carbon Disclosure Project for several years, and the Woolworths Sustainability Strategy 2007 – 2015 outlines a number of ambitious targets including:

- maintaining their 2006 carbon levels through to 2015 - 'a 40% reduction in carbon emissions on projected growth levels',
- a '25% reduction in carbon emissions per carton delivered by Woolworths-owned trucks by 2012', and;
- other Sustainability targets relating to water and waste.

The Woolworths strategy falls short of mandatory Sustainability reporting for their supply chain at this stage, but it is only a matter of time before the industry takes the lead from overseas initiatives like Wal-Mart's environmental scorecard. History shows us that when major Retailers are hit with a cost, (and the price of carbon will be a biggie), they will inevitably look to suppliers to help drive savings.

Meanwhile, a bevy of shopper and consumer research is indicating that more and more people are thinking about the carbon footprint of their purchases. Woolworths knows this. An interesting facet of the Woolworths Sustainability strategy is their commitment to sustainable sourcing of private label products. They have recognised that Sustainability as a purchase driver can deliver first mover competitive advantage for their private label. Branded FMCG products get set to be outgunned in the race for a more sustainable consumer universe!

Smart FMCGs will start preparing their carbon strategy now and be proactive rather than reactive. The smartest FMCGS will look more broadly to an overarching Sustainability strategy, not just carbon. Herein lies the *real* opportunity for competitive advantage.

What do we do about it?

With the carbon issue escalating, there is no doubt that companies need to:

1. account for their emissions,
2. reduce their emissions,
3. monitor, review / continue to report their emissions;
via a properly prepared GHG plan.

However, as with any strategy, the best place to start is with the bigger picture. GHG and carbon neutrality is one (albeit very important) part of the picture.

If you look at your carbon emissions in isolation, you may risk missing other threats and opportunities – such as water (another escalating and urgent issue in Australia), waste, social and economic factors, and importantly, your broader business drivers. An initiative that reduces your carbon footprint but impacts negatively on your water use, or on a regional community where you source your ingredients, is not going to do you any favours with Retailers or Shoppers.

So, any discussion about carbon footprint must be had within the broader context of organizational Sustainability. There are many definitions for Sustainability, and the agenda is moving very quickly. A pragmatic definition that we use at the FMCG Sustainability Institute is:

“Organising and running the business based on a set of principles, approaches and tools that focus the business on doing well economically, environmentally and socially.”

The assertion here is that sound ecological and social performance contributes to business success. Sustainable business practices save money through greater productivity and efficiency, and can increase profits via a more compelling value proposition (including investors / shareholders). So that old myth about green being more expensive can be relegated to the scrap heap along with the rest of the landfill – there are too many case studies now that prove otherwise.

The first question in devising a Sustainability Strategy, as with all business planning, is: why do it? There needs to be a clear business and holistic case. Followed by: where are we now?

Specifically, where are you in relation to where the FMCG industry is (looking to best competitors in the UK and the USA as the benchmarks for where the global industry is)?

Here is an FMCG Sustainability Institute tool for thinking about this – we have placed a pointer where most Australian FMCGs are right now: Sustainability is being talked about, but there is not much action – at least in the medium sized companies.



The FMCG sector best practice globally can be found at 'Sustainability is impacting core business' based on the activities of leaders such as Wal-Mart, Tesco and Unilever – but the majority of the sector (particularly the medium-sized companies) is lagging behind and is not uniformly embedding sustainability principles and practices just yet.

The 'ideal picture' can be found to the right at the point of convergence, where Sustainability becomes integrated into every facet of business operations.

Beyond carbon in isolation – understanding the three levels of Sustainability for true competitive advantage

Typically, when an organisation begins looking at Sustainability, the focus is on tactical activities. Energy, waste and water audits and carbon reduction plans, for example, fall in to this category, and whilst critical to any Sustainability strategy, they are a small part of the whole picture.

For us at the FMCG Sustainability Institute, Strategic Sustainability is different from Tactical Sustainability.

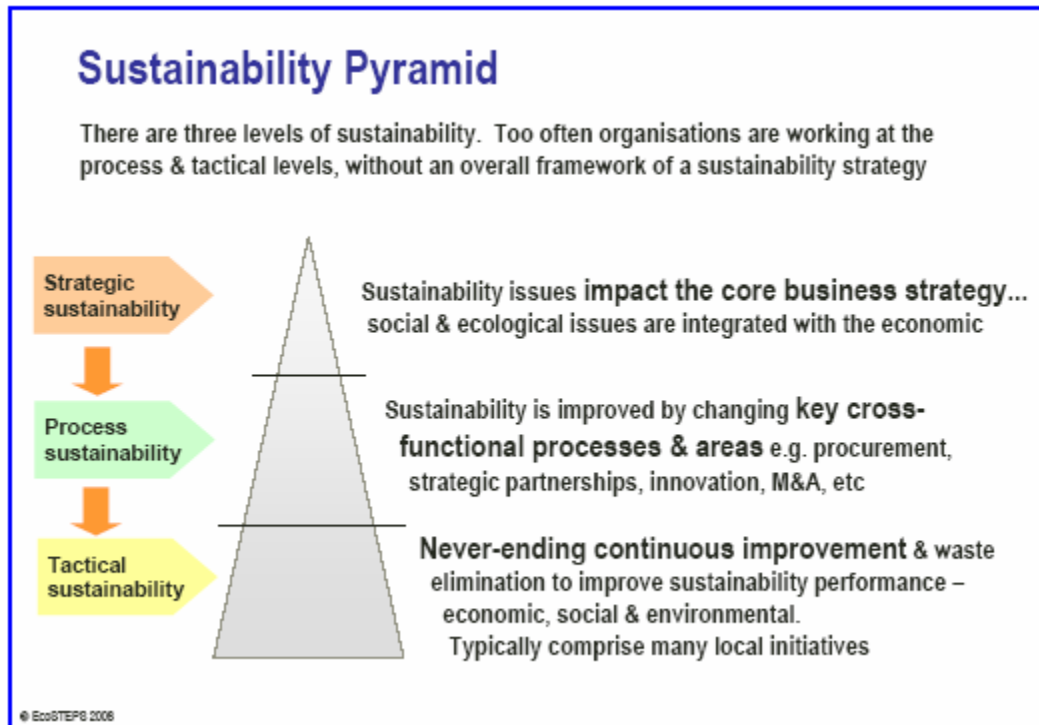
Strategic Sustainability is:

- integral to the business model and fundamental to the business;
- a source of differentiation, builds organisational reputation with key stakeholders and helps branding;
- gives a leading edge through innovation, patents, licences, low cost, speed to market and first mover advantage;
- hard to copy;
- builds margin and returns via increased prices, lower costs, lower assets; and importantly;
- it is likely to be specific to the firm, in the organisation's upstream business processes and is often externally focused.

Tactical Sustainability, on the other hand, is an 'add on' and does not impact core business – every firm can do it. It is not a source of differentiation; it offers no real leading edge (and in the case of carbon will become purely a compliance issue), and is easy to copy by competitors. It does not build margin because all firms use it and customers can compare and bargain. Tactical Sustainability is likely to be generic to the industry, in the organisation's downstream processes and often internally focused.

Linking Strategic and Tactical Sustainability is Process Sustainability which focuses on improving key cross-functional and organisation-wide processes in order to make the organisation more sustainable. Some of the processes may be strategic in nature (such as new product design), whereas others may be more tactical (e.g. green procurement of ingredients and downstream supply chain). When considering Strategic Sustainability we look for process improvements that give strategic advantage.

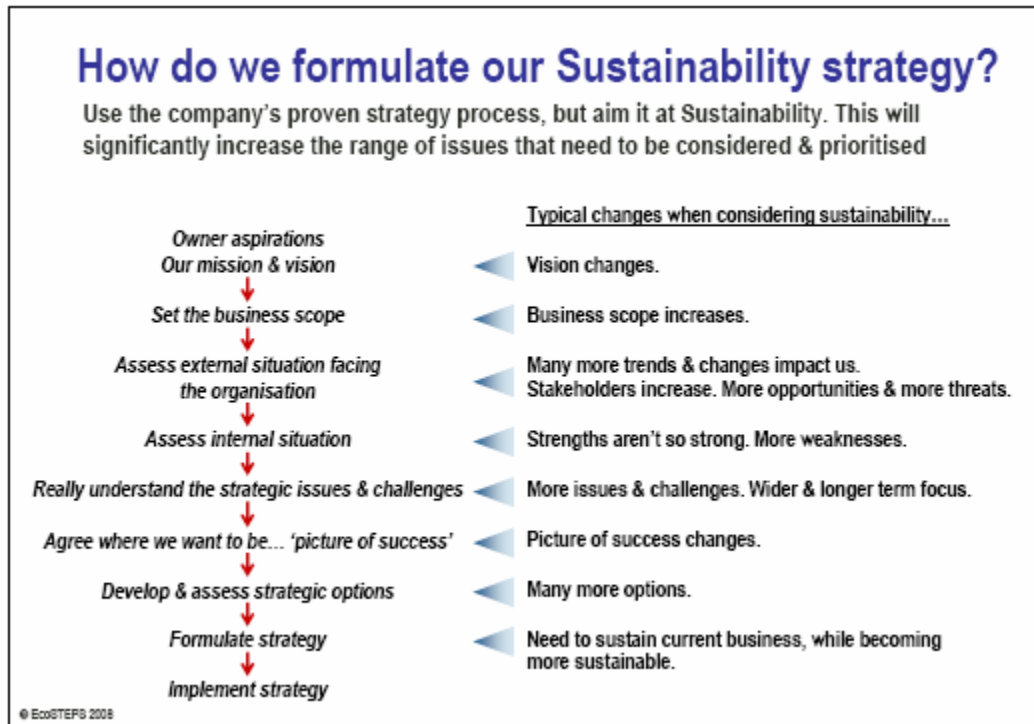
These three levels of Sustainability: Strategic, Process and Tactical are linked together as illustrated in the diagram below:



This distinction is helpful for senior FMCG executives to see why Sustainability can be important for their organisation. Sustainability is much more than carbon offsetting, green procurement and charitable donations. Implementing Sustainability to significantly help organisational performance requires assessment and innovation in relation to the strategic aspects of Sustainability.

How do we formulate our Sustainability Strategy? A snapshot:

Rather than creating a separate Sustainability Strategy process, the FMCG Sustainability Institute works with the company's current strategy process, but stretches the boundaries to the broader perspective of Sustainability. Doing this leads to many different questions at each step of the process, as illustrated below:



In summary:

1. In the new carbon economy, carbon reduction measures will become just a cost of doing business rather than a true competitive advantage. Retailers and shoppers alike will expect FMCGs to be proactive. Not reporting voluntarily creates a risk of an inaccurate and generic carbon cap being set for your company.
2. FMCGs need a GHG strategy, but in the broader context of Sustainability strategy.
3. Strategic Sustainability creates true differentiation and competitive advantage, as opposed to Tactical Sustainability (including carbon reduction measures) that other companies can copy. Process Sustainability links the two.
4. To formulate your Sustainability Strategy, ideally the existing strategy process of the organisation can be used and applied to the more holistic considerations of Sustainability. The overall business strategy will change as a result.

For more information on FMCG Sustainability, and on carbon emissions trading – how it works and what it means, visit the FMCG Sustainability Institute at www.fmcg-sustain.com.au

About the writers

The charter of the FMCG Sustainability Institute (FSI) is to provide thought leadership, research, education and advice on Sustainability to the FMCG industry.

During 2008, the FSI will be conducting industry-wide research on Sustainability issues, and providing training programs for FMCG and Retail companies.

The FSI is a joint initiative of Shoppportunity, FMCG and Retail market specialists, and EcoSTEPS, one of Australia's oldest and largest Sustainability companies. The Institute has an extended team of more than 30 Sustainability and FMCG professionals.

For all membership and other enquiries visit www.fmcg-sustain.com.au , email enquiries@fmcg-sustain.com.au or contact Lee McAllistair on 0414 941 585.

Julian Crawford, Founding Director

Julian is one of Australia's most widely recognised thought leaders and speakers on Sustainability issues. His background is in both science and business. Julian originally studied Zoology at Oxford University, then worked in the finance and banking industry in senior roles with PricewaterhouseCoopers in the UK, Europe and Australia. Julian is a Founding Director of EcoSTEPS, a one of Australia's most respected Sustainability consultancies, and the FMCG Sustainability Institute, launched in July 2008.

Lee McAllistair, Sustainability Marketing Director

Lee McAllistair has been a researcher and market strategist in the FMCG space for ten years. She has worked with major companies including Foster's Group, Blackmores and Orica. Lee specialises in sustainability-based research and marketing strategies, and is currently managing a number of major programs for blue chip companies. She holds a Masters in Communications Management and is currently undertaking further postgraduate study in Sustainable Business Management. Lee is Sustainability Marketing Director of the FMCG Sustainability Institute, and of Shoppportunity, FMCG market specialists.